STATEMENT

This matter arises out of an arbitration proceeding conducted under the Federal Arbitration Act ("FAA"). Petitioner is Metromedia Energy, Inc. ("MME"), a retail supplier of natural gas. Respondents are Enserch Energy Services, Inc., TXU Energy Company LLC, TXU Energy Trading, TXU Energy Services, n/k/a/ TXU Energy Retail Company, LP, and various TXU John Does (collectively, "TXU"). TXU is also a retail supplier of natural gas.

A. The Master Agreement and MME's Natural Gas Orders from TXU

In October 1998, MME entered into a contract with TXU (the "Master Agreement") for the supply of natural gas. Under the terms of the Master Agreement, TXU agreed to sell natural gas to MME at TXU's cost plus twenty-five percent of MME's gross profit. The Master Agreement contains an arbitration clause stipulating, in relevant part:

> [A]ny disagreement, difference, or dispute among the Parties ***arising under this Agreement*** shall be resolved pursuant to arbitration according to the procedures set forth in this Article XIV.

Master Agreement, Art. XIV, § 14.1, Pet. App. 42a (emphasis added). The Master Agreement further provides, in relevant part:

> The arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such rules do not conflict with the terms of such Act or the provisions of this Agreement.

Id., § 14.2, Pet. App. 43a.

MME ordered natural gas deliveries from TXU in two ways: (1) by written instructions, and (2) by telephonic "spot" orders. Between November of 2000 and February of 2001, MME placed numerous telephonic spot orders with TXU, and TXU sent invoices to MME for these orders.

In addition to purchasing natural gas from TXU, MME also sold natural gas to TXU. MME became concerned that TXU was overcharging MME for its deliveries of gas when MME discovered that during one period it had sold gas to TXU at $15 per decatherm unit, while at the same time TXU had sold gas to MME at $23 per decatherm unit. As a result, MME requested information from TXU regarding its pricing. When MME's request went unsatisfied, MME commenced an arbitration proceeding to discover TXU's costs and to determine whether TXU had overcharged MME in violation of the Master Agreement, which, as noted, called for pricing based upon TXU's cost plus a percentage of MME's gross profit.

B. The Arbitration Proceedings

In its pre-arbitration filings, MME submitted the following issues: (1) whether TXU had failed to permit MME to inspect TXU's books and records to determine whether TXU had overcharged MME in violation of the Master Agreement; (2) whether TXU had improperly drawn on a letter of credit securing MME's obligations to TXU; and (3) whether TXU had overcharged MME for telephonic spot orders between November 2000 and February 2001. Pet. App. 44a-45a. In response, TXU submitted the following issues: (1) whether MME breached the Master Agreement by failing to share gross profits with TXU; (2) whether MME failed to provide information to permit TXU to determine MME's gross profits; and (3) whether MME failed to pay certain amounts that it owed to TXU. Pet. App. 47a. Just prior to the arbitration hearing, MME and TXU settled and withdrew all of TXU's issues, and settled and withdrew the first two of MME's issues, leaving only MME's third issue of

whether TXU overcharged MME in violation of the Master Agreement. Pet. App. 48a.

A panel of three arbitrators held hearings on the dispute over a period of three days in September 2002. Thereafter, the parties submitted post-hearing briefs. MME argued that the evidence demonstrated that TXU had overcharged MME in violation of the Master Agreement. TXU denied that it had overcharged MME under the terms of the agreement, and argued in the alternative that the telephonic spot transactions did not fall under the Master Agreement at all, but, rather, fell under the terms of a "separate contract" between the parties arising as a "course of performance" entirely independent of the Master Agreement. Pet. App. 49a-50a. TXU never argued that this "separate contract" contained an arbitration provision, or otherwise required arbitration between the parties of any dispute arising under its terms.

On March 3, 2003, the arbitration panel issued its opinion in favor of TXU, expressly concluding that the Master Agreement did not apply to the controversy. The panel specifically determined that MME and TXU had "reached no agreement as to the price to be charged for [the telephonic spot orders] during the months of November 2000 through February 2001." Pet. App. 31a. The panel further concluded that the Master Agreement "does not govern the purchase price for [the telephonic spot orders of natural gas] sold to MME." Pet. App. 32a. Critically, although the arbitrators concluded that the Master Agreement did not apply to the controversy (and, *a fortiori*, that the arbitration clause in the Master Agreement did not apply because the clause applies only to disputes "arising under" the agreement), the arbitrators did not stop there. Instead, they proceeded to determine that TXU's charges for the gas delivered pursuant to the telephonic spot orders under the separate "course of performance" contract were "reasonable," even though this was not one of the issues submitted. Pet. App. 34a. As noted, following the parties' settlement of most of their issues just prior to the arbitration hearing, the only issue

submitted to the arbitrators was whether TXU had overcharged MME in violation of the Master Agreement. The arbitrators further concluded that TXU was the prevailing party in the arbitration, and ordered MME to pay a portion of TXU's costs and attorneys' fees. Pet. App. 36a.

In issuing their opinion, the arbitrators did not expressly analyze the scope of their authority, and they made no findings regarding the scope of the parties' submissions. Further, neither party submitted to the arbitrators the question of the arbitrators' authority to define their jurisdiction.

C. The Governing Law

This Court has explained that "'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986) (quoting *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960)). This rule "recognizes the fact that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." *AT&T*, 475 U.S. at 648-49 (citing *Gateway Coal Co. v. Mine Workers*, 414 U.S. 368, 374 (1974)).

This Court has further explained that the question whether the parties have agreed to submit a particular matter for arbitration (i.e., the question of the "arbitrability" of the dispute) is for the court to decide. *See AT&T*, 475 U.S. at 649 ("Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties have agreed to arbitrate is to be decided by the court, not the arbitrator."); *see also Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 84 (2002) ("[A] disagreement about whether an arbitration clause in a concededly binding contract applies to a particular type of controversy is for the court."). In addition, the Court has stated that, in conducting its review of any question of arbitrability, "the court should

decide that question just as it would decide any other question that the parties did not submit to arbitration, namely, independently." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995). Moreover, the Court has directed that, after the district court has conducted its review of the arbitrability of an issue, the court of appeals should review the district court's decision in the same manner that it would consider "any other district court decision finding an agreement between the parties, e.g., accepting findings of fact that are not 'clearly erroneous' but deciding questions of law *de novo*." *Id.* at 947-48.

Under the FAA, parties typically define arbitrability (i.e., the scope of the arbitrator's authority to resolve any particular issue) in two ways: (1) through the terms of their pre-negotiated contractual arbitration clause, and (2) through the terms of their submission of the issues for arbitration. *See, e.g., 187 Concourse Associates v. Fishman*, 399 F.3d 524, 527 (2d Cir. 2005) ("[T]he scope of authority of arbitrators generally depends on the intention of the parties to an arbitration, and is determined by the agreement or submission") (internal quotation marks and citation omitted); *American Postal Workers v. Runyon*, 185 F.3d 832, 835 (7th Cir. 1999) ("The parties may limit the arbitrator's contractual authority to address a dispute through: (1) the contract; and (2) the issue submitted to the arbitrator."); *Dorado Beach Hotel Corp. v. Union De Trabajadores De La Industria Gastronomica de Puerto Rico*, 959 F.2d 2, 4 (1st Cir. 1992) ("[A]n arbitrator's authority [under the parties' contract] may be supplemented by the parties' submissions."); *John Morrell & Co. v. Local Union*, 913 F.2d 544, 561 (8th Cir. 1990) ("[W]e must look both to their contract and to the submission of the issue to the arbitrator to determine his authority.") (emphasis, internal quotation marks, and citation omitted); *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir. 1982) ("[O]nce the parties have gone beyond their promise to arbitrate and have supplemented the agreement by defining the issue to be submitted to an arbitrator, courts must look both to the contract and the submission to determine his authority")

(citation omitted). Thus, even though a pre-negotiated contract may provide for the arbitration of certain issues, the parties may refine the scope of the arbitration proceeding by agreeing to submit a particular set of issues for resolution through arbitration. Under the express provisions of sections 10(a) and 11(b) of the FAA, a federal district court is authorized to ensure that an arbitrator stays within the bounds of his or her authority by vacating or modifying an arbitration award "[w]here the arbitrators exceeded their powers" or "[w]here the arbitrators have awarded upon a matter not submitted to them." 9 U.S.C. §§ 10(a) & 11(b).

Of course, the parties may agree that the arbitrator, rather than a court, may have the authority to decide the arbitrability of a particular issue under the parties' contract and submissions. But this Court has cautioned that this authority may not be presumed, and must rest upon "clear and unmistakable evidence" that the parties intended the arbitrator to decide arbitrability. *First Options*, 514 U.S. at 944 ("Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e]' evidence that they did so.") (quoting *AT&T*, 475 U.S. at 649). Under this standard, "merely arguing the arbitrability issue to an arbitrator does not indicate a clear willingness to arbitrate that issue, i.e., a willingness to be effectively bound by the arbitrator's decision on that point." *Id.* at 946. In this case, the parties did not argue or submit the issue of arbitrability to the arbitrators, and there is no evidence, let alone "clear and unmistakable" evidence, that MME agreed that the arbitrators would decide the arbitrability of the issues addressed in their award. Accordingly, this question is not implicated in this case. What is in dispute is whether the Third Circuit applied the correct standard of review in determining that the arbitrators did not exceed their authority in issuing their award.

D. Proceedings in the District Court and the Third Circuit

Following the arbitrators' issuance of their opinion, MME commenced a proceeding in the district court to vacate the arbitrators' award on the ground that the award exceeded the arbitrators' authority. The district court agreed, concluding that, "[h]aving found that the Master Agreement [containing the arbitration clause] did not apply to the [telephonic spot] sales, the arbitration panel had no authority to resolve the issues regarding the [independent] contract absent evidence that the parties submitted the issue of the reasonableness of the pricing under the [independent] contract to arbitration." Pet. App. 26a-27a. Conducting its own independent review, the district court expressly found that "the record in this matter does not support TXU's contention that MME and TXU submitted to the arbitrators issues regarding the terms of the [independent] contract and whether TXU's pricing pursuant to the [independent] contract was reasonable." Pet. App. 27a. The district court added: "After reviewing the record, the Court is satisfied that at no time did MME consent to have the panel determine what terms and conditions were applicable to the [independent] contract if the Master Agreement did not apply to the [telephonic spot] sales." *Id.* The district court then vacated the arbitration award "to the extent that it purports to determine the terms of the [independent] contract and . . . to the extent that it purports to determine the propriety of TXU's charges for [telephonic spot] sales from November 2000 to February 2001." Pet. App. 29a. The district court likewise vacated the award of attorneys' fees. *Id.*

TXU appealed the district court's decision to the Third Circuit. Rejecting the district court's standard of review, the Third Circuit reversed. Pet. App. 3a. The Third Circuit began by observing that it owed no deference to the district court's analysis. Further, the court concluded that the district court had erred because it failed to afford the arbitrators' award a heightened degree of deference.

In its brief to the Third Circuit, MME cited this Court's decision in *First Options* and stated that the applicable standard of review that a court of appeals employs in considering a district court's decision regarding the arbitrability of an issue is as follows: "[F]indings of fact are reviewed under the clearly erroneous standard, while questions of law are reviewed *de novo*." Appellee's Brief at 16, *Metromedia Energy, Inc. v. Enserch Energy Services*, 409 F.3d 574 (3d Cir. 2005) (No. 04-1944) ("MME Br."). The Third Circuit, however, applied a different standard, stating that "we owe no deference to the District Court's analysis, and instead we exercise plenary review over the District Court's decision to vacate the arbitration award." Pet. App. 9a.

In its brief to the Third Circuit, MME also cited this Court's decisions in *AT&T* and other cases, and argued that "[a]rbitration is a matter of contract and a party cannot be forced to arbitrate any dispute that it has not agreed by contract to submit." MME Br. at 25-26. MME argued further that the issue of arbitrability is for the court to decide, as the district court did in conducting its independent review in this case. MME Br. at 16. The Third Circuit plainly recognized that "MME's challenge to the arbitration award focuses not upon the underlying merits of the panel's analysis, but rather upon whether the panel exceeded its authority by resolving in its opinion an issue the parties had not agreed to arbitrate." Pet. App. 8a. The Third Circuit, however, rejected the district court's independent review. Adhering to its prior decisions in *Matteson v. Ryder Sys. Inc.*, 99 F.3d 108 (3d Cir. 1996), and *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2001), the court concluded:

> [T]he arbitrators have the authority in the first instance to interpret the scope of the parties' submissions in order to identify the issues that the parties intended to arbitrate. When confronted with an allegation that the arbitrators exceeded their authority by resolving an issue the parties did not intend to submit, we will review the arbitrator's

> interpretation of the parties' intentions under a 'highly deferential' standard.

Pet. App. 10a.

As noted, the arbitrators never expressly construed their authority under the Master Agreement or the parties' submissions in their written opinion. Accordingly, the Third Circuit lacked any formal, written analysis from the arbitrators to inform application of the court's "highly deferential" standard. Under the Third Circuit's approach, however, this did not matter because "a reviewing court should presume that an arbitrator acted within the scope of his or her authority" and that "this presumption may not be rebutted by an ambiguity in a written opinion." Pet. App. 14a. The Third Circuit then determined that, because TXU and the arbitrators could have believed that the arbitrators had the necessary authority, and "in light of the highly deferential standard of review that we must apply in assessing MME's challenge to the arbitration panel's interpretation of the scope of the parties' submissions, we believe the District Court erred in determining that the arbitration panel lacked the authority to address the reasonableness of TXU's [telephonic spot sales] prices." Pet. App. 18a.

REASONS FOR GRANTING THE WRIT

The courts of appeals are intractably divided over the proper standard of review to apply in considering whether, in issuing an arbitration award, the arbitrator exceeded his or her authority based upon the parties' contractual agreement and arbitration submissions. This disagreement involves *all* of the courts of appeals. Because the conflict among the courts of appeals is widespread, longstanding, and entrenched, and is unlikely to resolve itself absent intervention by this Court, certiorari review is warranted.

In addition, the decision of the court below conflicts with relevant decisions of this Court. In *First Options*, the Court directed that, at least with respect to an arbitrator's authority to decide an issue under the parties' pre-negotiated contractual agreement, the reviewing court is to conduct an *independent* review. *Id.* at 943. The court below, however, eschewed independence in favor of a highly deferential standard. Furthermore, although this Court has not specifically addressed the standard of review applicable in reviewing an arbitrator's authority based upon the parties' submission of the issues in preparation for the arbitration hearing, there is no reason why the standard should be any different. Both are facets of the same arbitrability question and both define the jurisdiction of the arbitrators. The principles articulated in *First Options* and other relevant decisions of this Court thus apply, and the decision of the court below conflicts with them.

The question presented is important because it implicates the ability of the parties to fashion and rely on their arbitration agreements and submissions. If parties cannot rely on their agreements and submissions, then arbitration will be discouraged. This case likewise presents an ideal vehicle for resolution of the conflict because the question is presented squarely and is outcome-determinative. Conducting an independent review, the district court concluded that the arbitrators exceeded their authority because they resolved issues beyond the scope of the arbitration clause in the Master Agreement and the parties' submissions. Applying a heightened standard of deference to the arbitrators' decision, the Third Circuit reached the opposite conclusion. The Third Circuit did not rule that the district court misapplied the standard of review that it employed, but, rather, that the district court should have applied a standard of heightened deference. The outcome of this case turns on the proper standard of review.

Finally, the decision of the Third Circuit is plainly in error. The correct standard of review is the standard that this Court adopted in *First Options*. Moreover, the Third Circuit's standard

fails to afford due regard to the command of the FAA, which expressly provides that it is for the court, not the arbitrator, to determine questions of arbitrability.

I. The Courts of Appeals Are Intractably Divided Over the Question Presented and Review in this Court Is Necessary and Warranted to Resolve the Conflict.

The decision below deepens an existing conflict among the courts of appeals over an issue on which all of the circuits have spoken. Moreover, the conflict involves more than a two-way split among the circuits, as the internal precedents *within* five of the circuits also stand in profound disarray. The broad division of authority among and within the courts of appeals demonstrates that certiorari is warranted.

Disputes regarding arbitrability typically arise in two contexts: (1) pre-arbitration (e.g., on a motion to compel arbitration before arbitration has actually begun); or (2) post-arbitration (e.g., in a proceeding to review an arbitral award where one party argues that it never agreed to arbitrate the particular dispute that the arbitrator decided). In the second context (which is the context *sub judice*), the courts of appeals are deeply divided over the appropriate standard of review. Further, the split of authority has two facets. First, courts disagree on the deference to be afforded an arbitrator's decision in the face of a claim that the decision exceeded the scope of the parties' pre-negotiated contractual agreement. Second, courts disagree on the deference to be afforded an arbitrator's decision in the face of a claim that the decision exceeded the scope of the parties' submission of the issues in preparation for the arbitration hearing. In general, courts agree that the standard of review should be same in both situations, but disagree on what that standard should be.

The Second, Fifth, Tenth, and Eleventh Circuits apply a *de novo* standard that recognizes that the question of arbitrability – i.e., whether the arbitrator is authorized to resolve a particular

issue under the parties' contract or submissions – is for the court to decide without deference to the arbitrator. *See Sarhank Group v. Oracle Corp.*, 404 F.3d 657, 661-62 (2d Cir. 2005) (holding that, because "arbitrability is not arbitrable in the absence of the parties' agreement, the district court was required to determine whether [the parties] had agreed to arbitrate," and that "the district court was not, as a matter of law, bound by the arbitrators' determination of arbitrability"); *187 Concourse Associates*, 399 F.3d at 526-27 (reviewing district court's "findings of fact for clear error and questions of law *de novo*" and affirming district court's vacatur of arbitration award on the basis that the arbitrator exceeded his authority because the "arbitrator's authority was limited by both the [parties contract] and the questions submitted by the parties for arbitration"); *JLM Indus., Inc. v. Stolt-Nielsen SA*, 387 F.3d 163, 169, 171 (2d Cir. 2004) (applying "*de novo*" standard and stating that "a disagreement about whether an arbitration clause . . . applies to a particular type of controversy is for the court") (internal quotation marks and citation omitted); *Local Union No. 898 v. XL Elec., Inc.*, 380 F.3d 868, 870 (5th Cir. 2004) (affirming district court's refusal to enforce arbitration award; stating that, in reviewing district court's determination regarding arbitrability, "we accept findings of fact that are not 'clearly erroneous' but review questions of law *de novo*," and that, "[a]s the district court noted, the question of arbitrability is a question for the court"); *Smith v. Currency Trading Int'l, Inc.*, No. 98-1311, 1999 U.S. App. LEXIS 18182, *5 (10th Cir. 1999) (affirming district court's decision to vacate an arbitration award because "the question of arbitrability was subject to independent review by the courts") (internal quotation marks and citation omitted); *GM Corp. v. Pamela Equities Corp.*, 146 F.3d 242, 248 (5th Cir. 1998) ("[C]ourts should not assume or conclude that the parties agreed to submit the question of the scope of the arbitrator's own authority to that arbitrator unless there is 'clear and unmistakable evidence' that they did so"); *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1321 (5th Cir. 1994) ("We begin by noting that the question of whether a party can be compelled to arbitrate, as well as the question of what issues a

party can be compelled to arbitrate, is an issue for the court rather than the arbitrator to decide."); *Bakery, Confectionary & Tobacco Workers Local Union Number 362-T v. Brown & Williamson Tobacco Corp.*, 971 F.2d 652, 655 (11th Cir. 1992) ("Although the arbitrator is confined to deciding issues properly before him, it is the court's task to determine what issues were originally submitted to the arbitrator."); *E.I. DuPont de Nemours & Co. v. Local 900*, 968 F.2d 456, 458 (5th Cir. 1992) ("Courts are free . . . 'to scrutinize the award to ensure that the arbitrator acted in conformity with the jurisdictional prerequisites of the [parties' agreement].'") (quoting *Delta Queen Steamboat Co. v. District 2 Marine Engineers Beneficial Ass'n*, 889 F.2d 599, 602 (5th Cir. 1989)); *Iron Workers Local No. 272 v. Bowen*, 624 F.2d 1255, 1264 (5th Cir. 1980) ("[D]etermining just what issues were submitted to an arbitrator is a task for the court") (citing *Refinery Employees Union v. Continental Oil Co.*, 268 F.2d 447, 451 (5th Cir. 1959) *cert denied*, 361 U.S. 896 (1959)); *see also Specht v. Netscape Communications Corp.*, 306 F.3d 17, 26-27 (2d Cir. 2002) (applying *de novo* standard and stating that, "[u]nless the parties clearly provide otherwise, the question of arbitrability – whether an . . . agreement creates a duty for the parties to arbitrate the particular grievance – is undeniably an issue for judicial determination") (internal quotation marks and citations omitted); *John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48, 53, 57-58 (2d Cir. 2001) ("Issues of 'arbitrability' are presumptively for the court to decide") (internal quotation marks and citation omitted); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1198 (2d Cir. 1996) ("Where the arbitration agreement contains an ambiguity as to *who* determines eligibility, the [FAA's] presumption favoring arbitration is reversed so that the court will ordinarily decide the question.") (emphasis in original); *cf. Devine v. Levin*, 739 F.2d 1567, 1570 (Fed. Cir. 1984) (noting that the question of arbitrability is for the court to decide).[1]

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[1] In administering the FAA in cases within its jurisdiction, the Federal

In contrast, the Third, Sixth, and Seventh Circuits give great deference to an arbitrator's decision regarding arbitrability. *See Metromedia Energy, Inc v. Enserch Energy Services, Inc*, 409 F.3d 574, 578-80 (3d Cir. 2005) (Pet. App. 1a) ("In determining the appropriate standard of review of the arbitrator's interpretation of the scope of the submission, we indicated that 'there is no doubt that our review of the interpretation of a submission is highly deferential.'") (quoting and citing *Matteson v. Ryder Sys., Inc.*, 99 F.3d 108, 113 (3d Cir. 1996); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 301 (3d Cir. 2001)); *Monee Nursery & Landscaping Co. v. International Union of Operating Engineers*, 348 F.3d 671, 676 (7th Cir. 2003) (recognizing that "an arbitrator's authority is [] limited by the actual issue submitted by the parties," but holding that "[t]he arbitrator's interpretation of the scope of the issue must be upheld so long as it is rationally derived from the parties' submission") (citing *American Postal Workers Union v. Runyon*, 185 F.3d 832, 835 (7th Cir. 1999)); *International Assoc. of Machinists & Aerospace Workers v. Tennessee Valley Auth.*, 155 F.3d 767, 772 (6th Cir. 1998) ("'The extraordinary deference given to an arbitrator's ultimate decision on the merits applies equally to an arbitrator's threshold decision that the parties have indeed submitted a particular issue for arbitration.'") (quoting *Champion Int'l Corp. v. United Paperworkers Int'l Union*, 779 F.2d 328, 335 (6th Cir. 1985)); *Mobil Oil Corp.*, 679 F.2d at 302 ("[W]e believe that the deference that is accorded to an arbitrator's interpretation of the [parties contract] should also be

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Circuit is "obligated to follow regional circuit law on questions of arbitrability that are not 'intimately involved in the substance of enforcement of a patent right.'" *Microchip Tech. Inc. v. U.S. Philips Corp.*, 367 F.3d 1350, 1356 (Fed. Cir. 2004) (quoting *Flex-Foot, Inc. v. CRP, Inc.*, 238 F.3d 1362, 1365 (Fed. Cir. 2001)). In *Flex-Foot* (a patent case) the court stated: "When reviewing district court decisions upholding arbitration awards, we accept findings of fact that are not clearly erroneous and decide questions of law *de novo*." 238 F.3d at 1365 (citing *First Options*, 514 U.S. at 948).

accorded to an arbitrator's interpretation of the issue submitted").[2]

In further contrast, decisions *within* the First, Fourth, Eighth, Ninth, and District of Columbia Circuits stand in confusing disarray. In some cases in which arbitrability is in dispute, these courts have applied a highly deferential standard of review. *See Madison Hotel v. Hotel & Rest. Employees, Local 25*, 144 F.3d 855, 857 (D.C. Cir. 1998) ("An arbitrator's view of the issues submitted to him for arbitration therefore receives the same judicial deference as an arbitrator's interpretation of [the parties' contract]."); *Boston & Maine Corp. v. Brotherhood of Maint. of Way Employees*, 94 F.3d 15, 19 (1st Cir. 1996) ("[A]n arbitrator's view of the scope of the issue committed to his or her care is entitled to the same far-reaching respect and deference as is normally accorded to the arbitrator's interpretation of the [parties' contract] itself."); *Richmond, Fredericksburg & Potomac RR. Co. v. Transportation Communications Int'l Union*, 973 F.2d 276, 280 (4th Cir. 1992) ("The arbitrator's interpretation of the scope of the issues is entitled to deference . . . and must be upheld so long as it is rationally derived from the parties' submission.") (citations and quotations omitted); *Volvo GM Heavy Truck Corp. v. International Union*, 914 F.2d 1493 (4th Cir. 1990) ("[T]he

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[2] It should be noted that the Third Circuit has not been entirely consistent in its approach. *See Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1512 (3d Cir. 1994) ("An arbitrator's decision to assert jurisdiction over objection is, however, subject to a much broader and more rigorous juridical review than an arbitral decision on the merits. Because it is 'a question for the court to decide,' it is subject to *de novo* judicial review.") (quotation marks and citation omitted), *aff'd, First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). Nevertheless, the more recent decisions in the Third Circuit, including the decision below, have, as noted, applied a highly deferential standard.

reviewing court must defer to an arbitrator's interpretation of the contours of the issues submitted") (internal quotation marks and citations omitted); *John Morrell & Co.*, 913 F.2d at 560 ("[A]n arbitrator's interpretation of the scope of the issue submitted to him is entitled to the same deference accorded his interpretation of the [parties' contract]"); *Pack Concrete, Inc. v. Cunningham*, 866 F.2d 283, 285 (9th Cir. 1989) ("We now hold that an arbitrator's interpretation of the scope of the issue submitted to him is entitled to the same deference accorded his interpretation of the [parties' contract].").

In other cases addressing the same issue, however, the very same courts have insisted that no deference be paid to the arbitrators' decision regarding arbitrability. *See Dow Corning Corp. v. Safety Nat'l Corp.*, 335 F.3d 742, 747 (8th Cir. 2003) (holding that the arbitrators exceeded their authority by deciding an issue that goes to the scope of their authority); *Coady v. Ashcraft & Gerel*, 223 F.3d 1, 9 (1st Cir. 2000) (reversing the district court's reliance on the view that it must defer to the arbitrator's decision regarding the scope of the submission; stating that, where the parties did not agree in their contract that the question of arbitrability was for the arbitrator to decide, "the arbitrators' views about what is arbitrable are not given the usual leeway courts give to arbitrators"; concluding that the arbitrators' views on the scope of their authority "carries no weight and is not entitled to deference"); *Champion Int'l Corp. v. United Paperworkers Int'l Union*, 168 F.3d 725, 728 (4th Cir. 1999) (observing that question of arbitrability is for the court to decide); *KenAmerican Res., Inc. v. International Union of United Mine Workers of Am.*, 99 F.3d 1161, 1163 (D.C. Cir. 1996) (stating that "[i]t is now settled that a federal court must decide *de novo* whether the parties agreed to arbitrate a particular dispute, unless the parties unmistakably indicate that arbitrability issues are to be decided by an arbitrator," and that, in resolving disputes over arbitrability "we may not afford any deference at all to the arbitrator's view on that issue"); *E.I. DuPont de Nemours & Co. v. Martinsville Nylon Employees Council Corp.*, No. 94-2222, 1996 U.S. App. LEXIS 3208, *6 (4th Cir. 1996)

("[W]e decide whether DuPont was required to submit the dispute . . . to arbitration without deferring to the decision of the arbitrator."); *Carpenters 46 N. Cal. Counties Conf. Bd. v. ZCON Builders*, 96 F.3d 410, 415 (9th Cir. 1996) ("[T]he district court erred in deferring to the arbitrator's decision" regarding arbitrability).

The Court should resolve this clear, protracted, and longstanding conflict among and within the courts of appeals. Unless this Court intervenes, the conflict is not likely to resolve itself, and permitting the conflict to continue is not likely to provide additional insight on how the question should be decided, given that all of the circuits (and innumerable lower courts) have examined the question with such divergent results.

II. The Decision of the Court Below Conflicts with Prior Decisions of this Court.

In this case, the Third Circuit has decided an important federal question in a way that conflicts with relevant decisions of this Court. Although the specific contexts of this Court's relevant precedents differ in some respects from the context of the instant case, the reasoning of the court below clearly conflicts with the governing principles that this Court has previously articulated in addressing the proper standard of review that a federal court should apply in addressing questions of arbitrability.

This Court has explained that, "'[u]nder our decisions, whether or not the company was bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the Court on the basis of the contract entered into by the parties.'" *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 546-47 (1964) (quoting *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241 (1962)). Likewise, the Court has explained that the relevant principles underlying this conclusion "are not new," but were established long ago "in a series of cases known as the *Steelworkers Trilogy*." *AT&T*, 475 U.S. at 648 (citing

Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960); *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960)).

As the Court stated in *AT&T*, "[t]he first principle gleaned from the *Trilogy* is that 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *AT&T*, 475 U.S. at 648 (quoting *Warrior & Gulf Navigation Co.*, 363 U.S. at 582)). Further, "[t]he second rule, which follows inexorably from the first, is that the question of arbitrability . . . is undeniably an issue for judicial determination." *AT&T*, 475 U.S. at 649. Thus, "[a]lthough the Court has also long recognized and enforced a 'liberal federal policy favoring arbitration agreements,' . . . it has made clear that there is an exception to this policy: The question whether the parties have submitted a particular dispute to arbitration, i.e., the '*question of arbitrability*,' is 'an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.'" *Howsam*, 537 U.S. at 83 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *AT&T*, 475 U.S. at 649; *First Options*, 514 U.S. at 944).

Where the parties have agreed in unmistakably clear terms that the arbitrator may resolve the arbitrability of a particular dispute, a court reviewing the arbitrator's decision "should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances." *First Options*, 514 U.S. at 943. On the other hand, where "the parties did *not* agree to submit the arbitrability question itself to arbitration, then the court should decide [the arbitrability] question just as it would decide any other question, namely, independently." *Id.* "After all," the Court continued, "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, . . . but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms, . . . and according to the

intentions of the parties." *Id.* at 947 (internal quotation marks and citations omitted).

In *First Options*, the Court likewise framed the relevant choice of review standards in the following way. On the one hand, "the Court of Appeals said that courts should *independently* decide whether an arbitration panel has jurisdiction over the merits of any particular dispute." *Id.* at 941 (internal quotation marks and citation omitted) (emphasis in original). On the other hand, "[Petitioner] asked us to decide whether this is so (i.e., whether courts, in reviewing the arbitrators' decision on arbitrability, should apply a *de novo* standard of review or the more deferential standard applied to arbitrators' decisions on the merits). . . ." *Id.* (internal quotation marks and citations omitted). On the merits, the Court clearly selected the former. *Id.* at 944-47.

The decision of the court below, adopting a "highly deferential" standard of review, plainly conflicts with this Court's analysis in *First Options*. Factually, *First Options* involved the question whether a person who had *not* executed a contract containing an arbitration clause could be bound by an arbitration award obtained *within* the scope of the authority otherwise conferred by the contract. In contrast, this case involves the question whether a party that *has* executed a contract containing an arbitration clause may be bound by an award conducted *outside* the scope of the authority conferred by the contract and the parties' submissions. Notwithstanding these factual differences, however, there is no principled reason why the relevant rules applicable to each should not be the same.

Either arbitrability is for a court to decide, or it is not. This Court has directed repeatedly that the question of arbitrability *is* for the court to decide, and affording great deference to arbitrators on the question of arbitrability is the antithesis of the Court's direction. Moreover, just as there is no reason to defer to an arbitrator's decision when a person cannot be bound by an award because he was not bound by the contract

under which the award was obtained, there is no reason to defer to an arbitrator's decision when a person cannot be bound by an award because the award exceeds the arbitrator's authority. If the parties wish to surrender their right to independent judicial review, they may do so by agreement, stating in clear and unmistakable terms that the arbitrator is to determine arbitrability. Where they have not do so, there is simply no basis to conclude that a court may surrender a party's right to independent judicial review of the question of arbitrability through application of a highly deferential standard of review.

III. The Conflict Among the Courts of Appeals Is Untenable, Given the Importance of the Question Presented, and this Case Presents an Ideal Vehicle to Resolve the Conflict.

The purpose of the FAA is to facilitate arbitration by promoting the use of contractual arbitration agreements. *See E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002); *Volt Info. Sciences v. Board of Trustees*, 489 U.S. 468, 479 (1989). In support of its goals, the FAA protects the integrity of the arbitration process by authorizing federal courts to ensure that arbitral proceedings and awards do not exceed the bounds of the arbitral authority conferred by the parties' agreement and submissions. *See* 9 U.S.C. §§ 10(a) & 11(b). If parties cannot be certain that the jurisdictional limits conferred by their agreements and submissions will be respected and enforced, they will be discouraged from entering into such agreements. Judicial review is thus important to ensure that the essential goals of the FAA are achieved.

In this case, the "highly deferential" standard endorsed by the court below, as well as by other courts of appeals, effectively erodes this essential certainty. Applying its highly deferential standard, the court below essentially concluded that the arbitration award would stand so long as the arbitrators might have believed that they had the necessary authority to make it, regardless of whether they actually had the necessary authority.

This approach effectively strips the parties of their right to define contractually the scope of an arbitration proceeding at the expense of the integrity of the proceedings themselves.

Because certainty of outcome is a key consideration in the crafting of any contract, the issue is one of great importance in the design and administration of arbitration agreements and proceedings. By the same token, the uncertainty generated by the conflict among the courts of appeals is correspondingly untenable, particularly in the five circuits that have internally inconsistent precedents. This is especially true for negotiated commercial arbitration agreements of the kind at issue in this case. Here, the parties expressly limited the scope of their arbitration clause in accordance with its specific terms, and they likewise expressly bargained for application of the FAA. Sections 10(a) and 11(b) of the FAA clearly reserve for the court the question of determining the arbitrability of issues, whether pursuant to the parties contract or through their submissions. The decision of the Third Circuit, like the decisions of other courts of appeals that apply a deferential standard, is unsettling precisely because it failed to honor the parties' agreement and the provisions of the FAA. This Court should intervene to correct the Third Circuit's error and remove the uncertainty created by the conflict among the courts of appeals.

This case presents an ideal vehicle to resolve the conflict because the question is presented squarely and is outcome-determinative. In this instance, the district court conducted an independent review of the arbitrators' award, concluding that the award must be vacated. In contrast, the court of appeals applied a standard of great deference, concluding that the award must stand. There is no suggestion that the district court applied its "independent review" standard incorrectly, only that, in the view of the court of appeals, it applied an incorrect standard. The selection of the appropriate standard is thus dispositive.

IV. Certiorari Is Warranted Because the Decision of the Court Below Is Wrong on the Merits.

Finally, for the reasons explained above, the decision of the court below is plainly in error and must be reversed. Based upon the principles that this Court has articulated and enforced repeatedly over a long series of decisions, the standard of review embraced by the court below is fundamentally flawed. The decision of the court below likewise stands at odds with the directives of sections 10(a) and 11(b) of the FAA, which prescribe that the question of arbitrability is for the court to decide. At the same time, the Third Circuit's decision is hardly an aberration. Rather, as indicated above, it adheres to prior circuit precedent and embraces the same erroneous standard of review that other courts of appeals have adopted and enforced over a long period of time. Accordingly, this Court should intervene to correct an error that otherwise will persist.

CONCLUSION

For the foregoing reasons, the Court should grant the petition.

Respectfully submitted,

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Dated: August 31, 2005

APPENDIX

APPENDIX A — OPINION OF THE COURT IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED JUNE 2, 2005

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Case No: 04-1944

METROMEDIA ENERGY, INC.

v.

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP,

Defendants/Third-Party Plaintiffs

v.

METROMEDIA COMPANY,

Third-Party Defendant

ENSERCH ENERGY SERVICES, INC; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP,

Appellants

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Argued March 29, 2005

OPINION OF THE COURT

SMITH, *Circuit Judge*.

In this case, we are called upon to review an arbitration award arising out of a dispute between TXU Energy Retail, LP ("TXU") and Metromedia Energy Services, Inc. ("MME") concerning a series of natural gas sales by TXU to MME. The March 3, 2003 arbitration award found that TXU had not overcharged MME for sales of natural gas that took place between November 2000 and February 2001. On April 10, 2003, MME responded to the arbitration award by filing suit against TXU in the District Court for the District of New Jersey. MME sought to vacate the award on the ground that the arbitration panel had exceeded its authority by addressing the reasonableness of TXU's prices for the disputed natural gas sales, after having first found that these sales were not subject to the pricing structure set forth in a 1998 Master Agreement between TXU and MME.

The District Court granted summary judgment in favor of MME, holding that the arbitration panel had exceeded its authority by addressing the reasonableness of the prices charged by TXU for sales not governed by the 1998 Master Agreement. The District Court also vacated the arbitration panel's award of attorneys fees, finding that the panel's decision concerning attorney fees "was necessarily based on the panel's inappropriate decision" concerning the reasonableness of TXU's prices. TXU appeals, arguing that the District Court's decision does not reflect the deference

due the arbitration panel's award under the Federal Arbitration Act ("FAA"), 9 U.S.C. § § 1-16. We agree, and accordingly will reverse the judgment of the District Court and remand with instructions to enter judgment in favor of TXU.

I. FACTUAL BACKGROUND

MME is a natural gas retailer that sells natural gas to end users in the northeastern United States. In October 1998, MME entered into a Master Agreement with appellant TXU, another natural gas retailer that undertook to obtain natural gas through a wholesale trading affiliate for delivery to MME. Under this Master Agreement, MME agreed to purchase gas from TXU pursuant to written confirmations that would specify the term, volume, and price for particular purchases. For a period of approximately two years after the signing of the Master Agreement, MME made purchases under the Agreement using written confirmations. MME also, on various occasions, made purchases of additional quantities of gas, the terms of which were negotiated by telephone with TXU representatives. These telephone transactions related to what the parties refer to as "spot-market" purchases. Spot-market transactions were transactions wherein a specified volume of gas would be ordered by MME for a one-month period only, and the price per dekatherm of such gas would not be provided by TXU until after the gas had been delivered. It also appears from the record that the telephonic spot-market transactions between the parties typically involved shorter lead times between order and delivery when compared to the purchases made by MME from TXU pursuant to the written confirmation process set forth in the Master Agreement.

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Article XIV of the Master Agreement contained an arbitration provision indicating that "any disagreement, difference or dispute among the Parties arising under this Agreement shall be resolved pursuant to arbitration according to the procedures set forth in this Article XIV." This arbitration clause called for each party to select one arbitrator, with the two initial arbitrators thus selected jointly selecting a third. The arbitration provision further provided that "[t]he arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such rules do not conflict with the terms of such Act or the provisions of this Agreement."

In October 2001, MME initiated arbitration proceedings against TXU pursuant to the arbitration clause contained in the Master Agreement. MME claimed that TXU had breached the Master Agreement by overcharging MME for various purchases of natural gas between November 2000 and February 2001. MME's initial statement of claims indicated that the telephonic spot-market purchases referenced above were among the purchases for which MME had allegedly been overcharged. In setting forth its cause of action for breach of contract, MME's statement of claims alleged that "TXU has further violated the Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases." (The parties refer to the period between November 2000 and February 2001 as the "Disputed Period").

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TXU responded to MME's claims by arguing that spot-market transactions between the two parties were not governed by the pricing provisions contained in Section 7.1 of the Master Agreement. Instead, TXU argued (in its Second Amended Response) that either (a) the prices for spot-market purchases were established under a separate course-of-dealing contract between TXU and MME; or (b) the course of dealing between TXU and MME had operated to modify the pricing provisions of the Master Agreement insofar as spot-market purchases were concerned.

The parties proceeded to arbitration, which resulted in a March 3, 2003 award in favor of TXU. The arbitration panel found that the spot-market purchases were not governed by the Master Agreement, and were instead subject to a separate "course of performance" contract. The latter arose from the parties' actual dealings, in which, according to the arbitration panel, TXU had charged prices that reasonably reflected market conditions at the time of each spot-market purchase by MME. The arbitration panel also awarded TXU one-third of its attorneys' fees, finding that TXU was the "prevailing party" in the arbitration and thus was the "non-defaulting party" under the attorney fee provision contained in the Master Agreement.

MME responded to the arbitration award by filing suit in District Court. MME sought to vacate the arbitration award on the ground that the arbitration panel, once having determined that spot-market purchases during the Disputed Period were governed by a separate course-of-performance contract, had exceeded its authority by also stating that TXU's prices under that contract were reasonable and accurately

reflective of prevailing market conditions. The District Court agreed, holding that the arbitration panel had exceeded its authority by determining the reasonableness of TXU's prices under the course-of-performance contract. The District Court also vacated the arbitration panel's award of attorneys' fees, finding that the panel's decision concerning attorney fees "was necessarily based on the panel's inappropriate decision that TXU's charges were reasonable under [the] spot gas contract...."

II. ANALYSIS

The District Court exercised diversity jurisdiction over MME's suit pursuant to 28 U.S.C. § 1332. We exercise appellate jurisdiction over the District Court's final order pursuant to 28 U.S.C. § 1291.

This appeal centers on the question of whether the arbitration panel exceeded the scope of its authority by stating in its written award decision that TXU's sales of spot-market gas to MME during the Disputed Period "were consistently priced and properly reflected market price on the dates volumes were requested and delivered." MME argued before the District Court that once the arbitration panel determined that TXU's spot-market sales were not governed by the pricing provision contained in the Master Agreement, the panel lacked authority to decide whether TXU's prices under a separate course-of-performance contract were reasonable and fairly reflected market conditions. MME based its argument on the fact that the Master Agreement's arbitration clause covers "any disagreement, difference or dispute among the Parties *arising under this Agreement* [.]" (Emphasis

added). MME argued that since the parties had agreed only to arbitrate disputes arising under the Master Agreement, the arbitration panel's finding that spot gas transactions during the Disputed Period *were not* governed by the Master Agreement deprived the panel of the authority to address the reasonableness of TXU's prices under an implied course-of-performance contract that lacked an arbitration clause. The District Court agreed with MME, holding that once the arbitration panel had determined that TXU's spot-market sales to MME were not subject to the Master Agreement, the panel's inquiry should have ceased. The District Court reasoned that the issue of whether TXU had or had not breached a separate course-of-performance contract was not a dispute arising under the Master Agreement, and thus was not subject to arbitration.

On appeal, TXU argues that the arbitration panel's award reflects a legitimate exercise of the panel's authority. TXU maintains that the submissions made by the parties during arbitration, taken as a whole, provided a reasonable basis for the arbitration panel to conclude that it was empowered to incorporate into award its findings concerning the reasonableness of TXU's spot-market prices in connection with sales to MME during the Disputed Period. TXU also argues that the District Court's decision fails to reflect the substantial deference owed by a federal court to an arbitration panel's award pursuant to the FAA.

Review of arbitration awards under the FAA is "extremely deferential." *Dluhos v. Strasberg*, 321 F.3d 365, 370 (3d Cir.2003). Vacatur is appropriate only in "exceedingly narrow" circumstances, such as where

arbitrators are partial or corrupt, or where an arbitration panel manifestly disregards, rather than merely erroneously interprets, the law. *See id.; Local 863 Int'l Bhd. of Teamsters v. Jersey Coast Egg Producers, Inc.*, 773 F.2d 530, 533 (3d Cir.1985) (stating that error of law is insufficient basis for vacatur). Likewise, an arbitrator's " 'improvident, even silly, factfinding' does not provide a basis for a reviewing court to refuse to enforce the award." *See Major League Umpires Assoc. v. American League of Professional Baseball Clubs*, 357 F.3d 272, 279-80 (3d Cir.2004) (quoting *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509, 121 S.Ct. 1724, 149 L.Ed.2d 740 (2001)).

Here, MME's challenge to the arbitration award focuses not upon the underlying merits of the panel's analysis, but rather upon whether the panel exceeded its authority by resolving in its opinion an issue the parties had not agreed to arbitrate. The District Court adopted MME's view, predicating its opinion on a provision in the FAA which indicates that an arbitration award may be vacated "if the arbitrators exceed their powers, or so imperfectly execute them that a mutual, final and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). The concerns raised by MME and the District Court arise from the principle that arbitration is a creature of contract, and an arbitration panel has the authority to decide only the issues that have been submitted for arbitration by the parties. *See Matteson v. Ryder Sys. Inc.*, 99 F.3d 108, 114 (3d Cir.1996).

In *Matteson*, we considered the standard of review applicable where a party seeks to vacate an arbitration award based upon allegations that the arbitrators exceeded the scope

of their authority by purporting to resolve issues the parties had not agreed to arbitrate. We began by explaining that in reviewing a district court decision concerning the validity of an arbitration award, our assessment of the arbitration panel's actions is governed by the same standard that governed the District Court's review. *See Matteson*, 99 F.3d at 112. Thus, we owe no deference to the District Court's analysis, and instead we exercise plenary review over the District Court's decision to vacate the arbitration award.

In relation to our review of the arbitration award itself, we noted that "an arbitrator has the authority to decide only the issues actually submitted" by the parties. *See id.* at 112-13 (citing *United Parcel Serv., Inc. v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, Local Union No. 430*, 55 F.3d 138, 142 (3d Cir.1995)). We then stated that "[i]t is the responsibility of the arbitrator in the first instance to interpret the scope of the parties' submission, but it is within the courts' province to review an arbitrator's interpretation." *Id.* at 113 (citing *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir.1982)). In determining the appropriate standard for our review of the arbitrator's interpretation of the scope of a submission, we indicated that "there is no doubt that our review of the interpretation of a submission is highly deferential." *Id.* We also rejected the argument that lesser deference should be accorded to an arbitrator's assessment of the scope of his own authority where such an assessment was based upon the arbitrator's factual determinations concerning which issues were actually submitted by the parties. *See id.* at 113 n. 6. However, we cautioned that "[e]ffusively deferential language

notwithstanding, the courts are neither entitled nor encouraged simply to 'rubber stamp' the interpretations and decisions of arbitrators." *Id.* at 113.

We noted in *Matteson* that our efforts to apply this standard of review were hampered by the parties' failure during the course of the arbitration jointly to prepare a single document listing the precise issues they wished to submit to the arbitration panel. *See id.* at 114. Under such circumstances, we held that "absent a formal, written submission, we must look to the parties' conduct as a whole." *Id.* We stated that "[t]o determine the intent of the parties given the circumstances in this case ... we cannot limit ourselves to simply one or a few documents." *Id.* We also stated that we would not focus upon isolated statements within the documents submitted by the parties, but would instead "examine the documents with an eye towards arranging each of them to create a complete picture." *Id.*

To summarize, *Matteson* indicates that the arbitrators have the authority in the first instance to interpret the scope of the parties' submissions in order to identify the issues that the parties intended to arbitrate. When confronted with an allegation that the arbitrators exceeded their authority by resolving an issue the parties did not intend to submit, we will review the arbitrator's interpretation of the parties' intentions under a "highly deferential" standard. Nonetheless, this deference is not a rubber stamp, and our review must focus upon the record as a whole in determining whether the arbitrators manifestly exceeded their authority in interpreting the scope of the parties' submissions.

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MME argues that the arbitration panel's written opinion in support of the arbitration award reveals that the panel exceeded its authority. Where an allegation that an arbitration panel has exceeded its authority is based upon the language of the written opinion in support of the panel's award, our decision in *Roadway Package System, Inc. v. Kayser,* 257 F.3d 287 (3d Cir.2001), provides additional guidance concerning our inquiry. In *Roadway Package,* after surveying earlier authority addressing such issues, we distilled three basic principles that must guide our review: "(1) a reviewing court should presume that an arbitrator acted within the scope of his or her authority; (2) this presumption may not be rebutted by an ambiguity in a written opinion; but (3) a court may conclude that an arbitrator exceeded his or her authority when it is obvious from the written opinion." 257 F.3d at 301.

With these principles in mind, we turn to MME's challenge to the arbitration panel's award. We must question at the outset the manner in which MME and the District Court have interpreted the panel's written opinion supporting its award. The District Court apparently adopted the view that the arbitration panel had first determined that TXU's spot-market sales to MME during the Disputed Period were governed by a course-of-performance contract, and had then, as a separate inquiry, determined that TXU charged reasonable, market-based prices under this course-of-performance contract. We do not believe the arbitration panel necessarily compartmentalized its analysis in this manner. An alternative reading of the panel's written opinion is that the panel assessed the evidence concerning the prices charged by TXU for spot-gas transactions, found that these prices

accurately reflected market conditions at the time, determined that these market-based prices met the expectations of *both parties* at the time of TXU's spot gas sales to MME, and then held, based on the mutual satisfaction of the parties' contemporaneous expectations, that spot-gas transactions were governed by an implied course-of-performance contract rather than by the pricing structure set forth in the 1998 Master Agreement.

Support for this reading flows from the sequence in which the arbitration panel set forth its factual findings on the second and third pages of its opinion. The panel cited testimony from TXU witnesses indicating that TXU intended all spot-gas sales during the Disputed Period to be "at then-current market prices otherwise available for sale and purchase at the specific delivery points[.]" The panel noted that these same witnesses testified that TXU's calculation of the market price for these transactions was based upon information drawn from the spot-gas market indices contained in the industry publications "*Inside FERC* " and "*Gas Daily.*" The panel also noted that documentation sent by TXU to MME in connection with these transactions indicated that the prices for spot-gas sales were different than the prices for purchases governed by written confirmations executed pursuant to the Master Agreement. The panel's opinion then discusses the testimony of MME witness Lawrence Morris, who apparently testified that "he recognized that the price for spot gas was not commensurate with the confirmed transaction price for each LDC, but that as long as the price was close to the Gas Daily index price for that period, he raised no objection and ultimately paid the price specified." After describing Morris's testimony in

this manner, the arbitration panel's opinion states: "Thus, agreement as to price for spot sales was independent of the Master Purchase Agreement and determined on a month-to-month basis."

When viewed in context, we believe this opening portion of the arbitration panel's written opinion highlights the fact that the panel's findings concerning the market-based nature of TXU's prices were not made as part of an independent inquiry, separate and apart from the finding that a course-of-performance contract rather than the Master Agreement governed TXU's spot-market sales to MME. Instead, these findings were part of the panel's rationale for why it believed a course-of-performance contract existed in the first place. The panel reviewed the evidence in the record, found that TXU had charged market-based prices, found that these market-based prices satisfied MME's expectations, found that MME was aware that these market-based prices differed from the prices that would have arisen under the Master Agreement's pricing provisions, found that MME raised no contemporaneous objection to these prices, and concluded based on these findings that the parties had intended to calculate the price for spot-gas sales on a month-to-month basis, independent of the pricing structure contained in the Master Agreement. In this context, there is no support for the District Court's view that the arbitration panel somehow exceeded its authority by following this chain of reasoning in the course of rejecting MME's breach of contract claim and concluding that TXU had not breached the Master Agreement.

We recognize, of course, that both MME and the District Court may have interpreted the arbitration panel's opinion as having first found that a course-of-performance contract existed, and only then having moved on to address the reasonableness of TXU's prices under this separate contract. This interpretation does not entirely make sense, because it seems more logical to believe that the arbitration panel first made its findings concerning what the parties' course of performance actually was, and then considered whether this course of performance reflected mutually-held expectations such that it could be said to constitute a separate contractual arrangement independent of the Master Agreement. It is not possible for us to say with complete certainty which interpretation most accurately captures the actual intentions of the arbitration panel. However, we find that the interpretation discussed at length above is a reasonable reading of the arbitration panel's written opinion. Given this fact, the District Court was wrong to seize on a contrary reading and to invoke that reading as a basis for concluding that the arbitration panel exceeded its authority. The District Court's approach runs afoul of the core principles identified in *Roadway Package,* which held that "a reviewing court should presume that an arbitrator acted within the scope of his or her authority" and that "this presumption may not be rebutted by an ambiguity in a written opinion." *See Roadway Package System, Inc.*, 257 F.3d at 301.

Moreover, even if we were to adopt the District Court's interpretation of the arbitration panel's written opinion, we would still uphold the panel's award. Here, as in *Matteson,* the parties failed to submit to the arbitrators a single comprehensive document listing the precise issues that the

arbitrators were being asked to resolve. Thus, if we were to assume that the arbitration panel's findings concerning the reasonable, market-based nature of TXU's spot-market prices were not simply part of the panel's rationale for rejecting MME's claim that the Master Agreement applied to spot-market transactions, we would review the record as a whole to determine whether the arbitration panel reasonably believed the parties had submitted to it the issue of whether TXU's spot-market prices reasonably reflected prevailing market conditions. *See Matteson*, 99 F.3d at 114. While our review of such issues cannot be a "rubber stamp," it is clear that we must take a "highly deferential" approach in considering whether an arbitration panel has reasonably interpreted the scope of the parties' submissions. *See id.* at 113.

We believe the record as a whole provided an adequate basis upon which the arbitration panel could conclude that it was empowered to address the reasonableness of TXU's spot-gas prices in the event that a course-of-performance contract rather than the Master Agreement governed the parties' spot-gas transactions. The "Causes of Action" section in MME's initial Statement of Claims alleged that "TXU has further violated the [Master] Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases." This section does not reference Appendix I of the Master Agreement, which defines the "Contract Price" for purposes of sales governed by the Agreement. Thus, both TXU and the arbitration panel may reasonably have believed that MME's overcharge allegations were predicated upon multiple factors depending upon the specific sales in

question. Certainly, it is clear from the record that TXU believed that the issue of whether its spot-gas prices reasonably reflected market conditions was implicated by MME's claims, and thus was before the arbitrators. For example, TXU's pre-arbitration brief described the testimony TXU intended to elicit during the arbitration hearing. Among other things, TXU stated that its testimony would establish that "as is customary in the natural gas industry, TXU Energy often purchased this spot gas on the open market, delivered the gas to MME *and charged MME a market-based price for the gas.*" (Emphasis added). A later subheading near the conclusion of the same brief asserted that "[t]he price charged by TXU Energy for spot gas was both market-based and consistent with the parties' course-of-performance." In support of this assertion, TXU indicated that "testimony will amply show that the price charged by TXU Energy to MME for spot gas during the relevant time period was based on the parties' course-of-performance and was well within the market price ranges published in both *Inside FERC* and *Gas Daily.*"

Consistent with its pre-hearing brief, TXU apparently introduced testimony during the course of the arbitration concerning the extent to which the prices for its spot-market sales to MME were consistent with prevailing market conditions as reflected in the leading industry pricing indices during the Disputed Period. TXU discussed this testimony in its post-hearing briefing, focusing primarily upon testimony provided by one of TXU's expert witnesses, and arguing based on this testimony that "there is almost always a range of reasonableness and not just a single number that can be reasonable," and that the prices for TXU's spot-market

sales to MME fell within this range. TXU's post-hearing brief also discussed documentary evidence in the form of letters sent by MME to various MME customers during 2001, in which MME defended its recent price increases by noting that market prices for natural gas had risen substantially during the prior months. TXU argued that these MME letters established three key facts: "(1) [that] MME, and not just TXU Energy, was justifying its spot gas prices based on the *Gas Daily* index range, which reflects the market; (2) [that] the market had spiked dramatically due to weather; and (3) [that] the $23.00 price was within the market range and therefore reasonable."

Based on the excerpts and testimony discussed above, it appears that TXU believed throughout the arbitration proceedings that MME's claims might implicate the question of whether TXU had charged reasonable, market-based prices for its spot-market sales to MME during the Disputed Period. Notably, at no point during the arbitration proceedings did MME raise the jurisdictional concerns that it now invokes. For example, MME never argued that TXU's repeated references in its opening brief to the market-based nature of its spot-market prices were irrelevant, on the ground that resolving that issue was beyond the scope of the arbitration panel's authority. Nor does MME appear to have objected to the evidence introduced by TXU at the arbitration hearing with respect to the correlation between TXU's spot-market prices and the market-based range of acceptable prices established by the leading industry pricing indices during the Disputed Period. Even when TXU's post-hearing brief made it crystal clear that TXU believed the arbitrators were empowered to address the reasonableness of its spot-market

prices during the Disputed Period, MME chose not to send a letter or seek leave to file a reply challenging TXU's submission of an issue that MME had (supposedly) not agreed to arbitrate.

Thus, at the time the arbitration panel crafted its written opinion in support of its award, it was faced with a record in which one party had repeatedly presented evidence and arguments concerning the reasonableness of its spot-market prices under a course-of-performance contract during the Disputed Period, and the other party had never objected to these arguments on the ground that this issue was beyond the scope of the panel's authority. Accordingly, even if we were to adopt the District Court's interpretation of the arbitration panel's written opinion, we would hold that TXU's briefs and hearing testimony, combined with MME's acquiescence to TXU's presentation of the issue, provided the arbitration panel with a reasonable basis to conclude that it was empowered to address whether TXU's spot-market prices under the course-of-performance contract accurately reflected market conditions at the time of the spot-market sales to MME. Therefore, in light of the highly deferential standard of review that we must apply in assessing MME's challenge to the arbitration panel's interpretation of the scope of the parties' submissions, we believe the District Court erred in determining that the arbitration panel lacked the authority to address the reasonableness of TXU's spot-market prices.

Having found that the arbitration panel did not exceed its authority, we also hold that the District Court erred in vacating the panel's award of attorneys' fees to TXU. The

arbitration panel found that TXU was the "prevailing party" in the arbitration and thus was the "non-defaulting party" under the attorney fee provision contained in the Master Agreement. MME mounts a broad challenge to this fee award, arguing that even if we reverse the District Court's opinion vacating the substance of the arbitration panel's award decision, we nonetheless should affirm the District Court's vacatur of the fee award. MME argues that the arbitration panel's fee award, pursuant to the Master Agreement's attorney fee provision, "is inconsistent with [the panel's] conclusion that the Agreement did not apply to the parties' dispute."

This argument makes little sense. The Master Agreement's fee provision indicated that "[t]he defaulting Party shall pay all reasonable costs and expenses (including attorney's fees) incurred by the non-defaulting party in the enforcement of its rights under this Agreement, whether incurred through legal action or otherwise." MME initiated arbitration against TXU, and asserted largely unsuccessful claims that TXU had breached the Master Agreement. TXU, in response to MME's initiation of arbitration, filed counterclaims against MME, and recovered $1,830,866.19 in settlement of these counterclaims prior to completion of the arbitration proceedings. Based on these facts, the arbitration panel reasoned that because TXU had successfully defeated the bulk of MME's overcharge claims under the Master Agreement, and had recovered a substantial sum in settlement of its counterclaims filed in connection with the arbitration proceedings, TXU was the "non-defaulting party" under the Master Agreement's fee provision, and thus was entitled to recover its reasonable costs and expenses. Contrary

to MME's assertion, the arbitration panel's reliance on the existence of a separate course-of-performance contract, as part of its basis for rejecting MME's overcharge claims under the Master Agreement, is in no way inconsistent with the panel's finding that TXU was the "non-defaulting party" under the Master Agreement's fee provision. Moreover, our review of arbitration awards is "extremely deferential," *see Dluhos,* 321 F.3d at 370, and we must uphold the arbitration panel's award so long as it "draws its essence" from or "arguably construes or applies" the parties' contract, a standard that we are confident is satisfied by the panel's decision here. *See News Am. Pub. v. Newark Typographical Union,* 918 F.2d 21, 24 (3d Cir.1990).

For the foregoing reasons, the decision of the District Court is reversed, and the case is remanded with instructions to enter judgment in favor of TXU.

APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY DATED MARCH 1, 2004

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Hon. Stanley R. Chesler
Civ. A. No. 03-1561(SRC)

METROMEDIA ENERGY, INC.,

Plaintiff,

v.

ENSEARCH ENERGY SERVICES, INC., TXU ENERGY COMPANY LLC, TXU ENERGY TRADING, TXU ENERGY SERVICES, n/k/a TXU ENERGY RETAIL COMPANY, LP, and TXU John Does,

Defendants.

TXU ENERGY SERVICES, n/k/a
TXU ENERGY RETAIL COMPANY, LP,

Third-Party Plaintiff,

METROMEDIA COMPANY,

Third-Party Defendant.

Appendix B

OPINION

CHESLER, District Judge

This matter comes before the Court upon the motion by plaintiff and third-party defendant Metromedia Energy, Inc., ("MME") for partial summary judgment vacating the arbitration award in the matter *Metromedia Energy, Inc. v. TXU Energy Trading Co.*, No. 71 Y 198 00887 1 (Mar. 3, 2003), before the American Arbitration Association and defendants TXU Energy Services n/k/a TXU Energy Retail Company, LP, Ensearch Energy Services, Inc., TXU Energy Trading Company LP n/k/a TXU Portfolio Management Company LP, TXU Energy Company LLC, and TXU John Does (collectively, "TXU") motion for summary judgment seeking confirmation of the arbitration award in the proceeding before the American Arbitration Association (the "arbitration). For the reasons set forth below, the Court will grant plaintiff's motion and vacate the arbitration award. Defendants' motion will be denied.

BACKGROUND

The facts of this case are well-known to the parties and thus the Court will only discuss those facts necessary to decide the pending motions. MME and TXU entered into a Master Gas Sale/Purchase Agreement (the "Master Agreement") on October 8, 1998, that governed the parties "term[1]" gas transactions. In addition to the parties' term sales, MME and TXU entered into certain "spot[2]" gas transactions

1. "Term" sales were those in which the parties agreed in advance to the price of the gas to be purchased.

2. "Spot" sales were those made without prior agreement by the parties and whose price was determined by the current market rate.

that are central to the dispute here. Specifically, MME contends that TXU overcharged it for the "spot" gas TXU sold to MME between November 2000 and February 2001. Believing that the parties' spot gas sales governed were by the Master Agreement, MME exercised its rights pursuant to Section 12.1 of the Agreement to either sue TXU in court or pursue its claims in arbitration.[3]

During the parties' arbitration, MME alleged that because the spot gas sales were subject to the Master Agreement, TXU was obliged to adhere to the pricing provision of the Master Agreement in its spot gas transactions. In other words, MME argued that the spot gas transactions were to be charged according the "Contract Price" as set forth in the Master Agreement.[4]

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3. Section 12.1 of the Master Agreement provides, in pertinent part, that

> Subject to the provision of Article XIV, upon the occurrence of an Event of Default, the Party which has not committed the Event of Default. . . . will have the right to exercise all rights and remedies available to it under this Agreement . . . including the rights (a) to initiate binding arbitration proceedings . . . to seek damages, [and] (b) to file suit to compel the Party which has committed the Event of Default. . . to perform[.]

4. Appendix ! to the Master Agreement defines "Contract Price" as follows:

> "**Contract Price**" means the price per MMBtu, expressed in U.S. Dollars, for which Gas is sold and

(Cont'd)

Conversely, TXU maintained that the spot gas transactions were not covered by the Master Agreement, and thus were not be charged according to the Contract Price. Indeed, TXU argued that the spot gas sales were not only outside the Master Agreement, but were, in fact, a separate contract formed within the provisions of Article Two of the Uniform Commercial Code ("UCC"). As a result of the second contract governing spot gas sales, TXU considered the pricing provisions of the Master Agreement inapplicable and therefore priced the spot sales in accordance with market prices. TXU further claimed that the prices it charged for the spot sales were reasonable under prevailing market rates.

The Arbitration panel ruled on March 3, 2001, that the Master Agreement did not apply to the spot gas sales, but that the spot gas sales were governed by a separate contract fanned by the parties' course of performance. *See* Arbitration Award at 3. The panel also found that the market prices that TXU charged for the spot gas sales were "within the range of applicable indices" and that there was no evidence that TXU artificially increased prices or 'gouged' the price for

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(Cont'd)

> purchased pursuant to a Transaction, as specified on the applicable Confirmation. The Contract Price shall be a function of cost plus profit share, Cost, shall generally be set at a NYMEX plus basis at the time the contract between Buyer and the Customer . . . is entered. On a case-by-case basis, Buyer may add an amount . . . based upon Customer credit, market conditions, and other relevant factors. The Gross Profit for each Transaction will be set out on the Transaction Confirmation prepared for the Transaction.

incremental spot sales during this volatile period." *See id.* at 5. The panel further noted that since TXU's position was ultimately vindicated by the arbitration panel, TXU was entitled to "some award for reasonable costs and attorney fees . . . under the contract." *See id.* at 6-7. The panel awarded TXU one-third of its attorneys' fees in connection with the arbitration. *Id.*

DISCUSSION

In its motion, MME argues that the arbitration panel had no authority to decide that the prices TXU charged for the spot gas transactions were reasonable. In fact, MME maintains that once the arbitration panel found that a course of performance contract governed the spot gas transactions and not the Master Agreement, the panel lost its authority to hear decide questions under the course of performance contract (the "spot gas contract"). Further, MME asserts that the arbitration award should be vacated *in toto* because TXU had impermissible ex parte communications with a member of the arbitration panel.

It is well-settled that the scope of an arbitrator's authority is "derived either from the agreement between the parties or from the parties submissions to the arbitrators. *Mutual Fire, Marine & Inland Ins. Co. v. NORAD Reinsurance Co., Ltd.*, 868 F.2d 52, 56 (3d Cir. 1989) (citing *Swift Indus. v. Botany Indus.*, 466 F.2d 1125, 1131 (3d Cir. 1972)); *see also United Indus. Workers v. Gov't of the Virgin Islands*, 987 F.2d 162, 168 (3d Cir. 1993) ("An arbitration agreement, however, need not be express, but also may be inferred from the conduct of

the parties."); *Peruvian Connection, Ltd. v. Christian*, 977 F. Supp. 1107, 1111 (D. Kan. 1991) ("Even if a particular dispute is not within the original arbitration agreement between the parties, it is hornbook law that parties by their conduct may agree to send issues outside an arbitration clause to arbitration." (Quotation omitted).

The Federal Arbitration Act ("FAA") provides, however, that a court may vacate an arbitration award if "*the arbitrators exceeded their powers*, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made." 9 U.S.C. §10(a)(4) (emphasis added). Consequently, "[i]t is the responsibility of the arbitrator in the first instance to interpret the scope of the parties' submission, but it is within the courts' province to review an arbitrator's interpretation." *Matteson v. Ryder Sys. Inc.*, 99 F.3d 108, 113 (3d Cir. 1996) (citing *Mobile Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299, 302 (3d Cir. 1982)).

Here, the arbitration panel concluded that MME and TXU "reached no agreement as to the price to be charged for incremental/spot gas volumes delivered by TXU to MME . . . during the months of November 2000 through February 2001." *See* Arbitration Award at 1. Accordingly, the panel found that "the Master Purchase Agreement does not govern the purchase price for incremental spot gas sold to MME" and that those sales were governed by a separate spot gas contract. *Id.* at 3. Having found that the Master Agreement did not apply to the spot gas sales, the arbitration panel had no authority to resolve the issues regarding the spot gas contract absent evidence that the parties submitted the issue

of the reasonableness of the pricing under the spot gas contract to arbitration. The Court concludes that the record in this matter does not support TXU's contention that MME and TXU submitted to the arbitrators issues regarding the terms of the spot gas contract and whether TXU's pricing pursuant to the spot gas contract was reasonable.

In particular, the Court notes that the central dispute between the parties in the arbitration was whether the Master Agreement applied to the spot gas sales, and more specifically, whether the pricing Provisions of the Master Agreement applied to the spot gas sales. After reviewing the record, the Court is satisfied that at no time did MME consent to have the panel determine what terms and conditions were applicable to the spot gas contract if the Master Agreement did not apply to the spot gas sales.

Indeed, the record reflects that TXU raised the notion of an oral spot gas contract only as an affirmative defense to MME's claim that the Master Agreement applied to spot gas sales. As MME notes, "[n]o party asked the arbitration panel to make a determination of the terms and conditions of any separate agreement nor did any party ask the panel to determine if the prices charged by TXU were reasonable." Affidavit of Steve Chiscano in Opposition to Defendants' and Counter Plaintiffs' Motion for Summary Judgment at ¶ 6 ("Chiscano Aff. at ¶ __"). In such circumstances, "an [arbitration] award will, of course, be enforceable only to the extent it does not exceed the scope of the parties' submission." *United Parcel Serv., Inc. v. Int'l Brotherhood*

of Teamsters, Chauffers, Warehousemen and Helpers of Am., Local Union No. 430, 55 F.3d 138, 142 (3d Cir. 1995).

Having found that the panel's determination in respect of the terms and reasonableness of the pricing under the spot gas contract exceeded the panel's authority and must be vacated, the Court also will vacate the attorneys' fee award granted to TXU. It is clear to the court that the attorneys' fee award was predicated, at least in part, on the panel's conclusion that TXU was a prevailing party in the arbitration and thus permitted a fee award as a "non-defaulting" party under the Master Agreement. *See* Master Agreement at §12.1. Since that finding was necessarily based on the panel's inappropriate decision that TXU's charges were reasonable under spot gas contract, it follows that the attorneys' fee award must be vacated.

Further, MME urges the Court that the entire arbitration award should be vacated based on alleged improper communication between counsel for TXU and its party arbitrator Peyton Feltus after an order by neutral arbitrator Ernest Edwards, Jr. MME's request must be denied.

It is clear that the Court has the power to vacate an arbitration award where the "arbitrators were guilty of . . . any other misbehavior by which the rights of the party have been prejudiced." 9 U.S.C. §10(a)(3). However, the "burden of proof [rests] squarely on the shoulders of the [moving party] to show that prejudicial ex parte communications took place." *NORAD*, 868 F.2d at 57. Here, after reviewing the record, the Court is satisfied that the communications between TXU's counsel and its party arbitrator were not improper.

Indeed, the record reflects that although Mr. Edwards had imposed a ban on ex parte communications, that ban was lifted on January 22, 2003, prior to TXU's communications with Mr. Feltus. *See* Affidavit of Thomas F. Lillard at ¶ 4. Further, the Court perceives no prejudice from TXU's de minimus communications with Mr. Feltus. In short, the Court will not find impropriety in this case sufficient to vacate the panel's award where a party arbitrator who, at the very least, is sympathetic to that party's position, communicates with its party during an arbitration. Additionally, MME has not been able to demonstrate to the Court how it was prejudiced by those contacts. Accordingly, the Court will deny MME's request to vacate the entire arbitration award.

Lastly, as the Court noted during oral argument, the applications by the parties concerning the stipulated settlement of TXU's counterclaims in this case will be denied pending further submissions by the parties.

CONCLUSION

For the foregoing reasons, the Court will grant plaintiff's motion to vacate the arbitration award to the extent that it purports to determine the terms of the spot gas contract and the to the extent that its purports to determine the propriety of TXU's charges for spot gas sales from November 2000 to February 2001. The Court further will vacate the attorneys' fee award. Finally, the Court will deny the parties' application to confirm that part of the arbitration award concerning the stipulated settlement of TXU's counterclaims pending further briefing.

s/
Stanley R. Chesler, U.S.D.J.

APPENDIX C — ARBITRATION AWARD AND FINAL ORDER IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED MAY 1, 2003

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

No. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.

Claimant,

VERSUS

TXU ENERGY TRADING CO.-L.U.

Respondent.

ARBITRATION AWARD AND FINAL ORDER

Article XIV of the Master Gas Sale/Purchase Agreement ("Master Purchase Agreernent") at issue requires that the judgment in the matter be rendered by the Chairman of the Arbitration Panel; however, each of the issues raised by both parties has been thoroughly discussed and debated by the Panel as a whole and this Award represents the unanimous vote of the Panel as well as the ruling of the Chairman with the exception of the Chairman's award of attorney's fees and costs to which Mr. Kasey objects. Based on the pleadings, responses to discovery requests, testimony of fact and expert witnesses, exhibits introduced at the hearing on the merits, pre- and post-trial briefs, and post-hearing information

provided at the request of the Arbitration Panel, it is the opinion of the Arbitration Panel that Metromedia Energy, Inc. ("MME") and TXU Retail Services ("TXU Retail") reached no agreement as to the price to be charged for incremental/spot gas volumes delivered by TXU to MME at various LDC delivery points during the months of November 2000 through February 2001.

MME claims that the Master Purchase Agreement is a full-requirements contract, that the price for all incremental spotgas delivered to MME for resale to various customers behind LDC delivery points/city gates with confirmed transaction prices must be sold at those contirmed prices, and that the price to be charged for incremental gas for "cost plus" customers is TXU Energy Trading Company's ("TXU Trading") net weighted avenge cost of gas after due consideration of hedges, swaps, and other financial transactions which TXU Trading entered to minimize the booked cost of gas for physical delivery to MME.

TXU argues that (a) the Master Purchase Aareement covers only confirmed transactions pursuant to which a specific volume and price for delivery of gas has been agreed to and confirmed by e-mail or written agreement, and (b) the Master Purchase Agreement does not govern the sale of any incremental gas not otherwise covered by a swing option on confirmed transactions for purchases at specific LDC delivery points. Witnesses of TXU testified that all spot sales were to be at then-current market prices otherwise available for sale and purchase at the specific delivery points, but determined generally in accord with either Inside FERC plus basis for those purchases made after the close of bid week but before

close of pipeline nominations for the following month or Gas Daily's daily monthly average for a request for additional intra-month supplies.

A single price was charged for all incremental spot gas deliveries on the monthly invoices to MME irrespective of whether the spot gas was purchased in advance of the month at the close of bid week or requested and priced on a day-to-day basis during the month in question. That average, incremental spot gas price was set out separately for each delivery point and clearly was not the same as prices for that month for any confirmed transaction. Prior to the volumes of incremental spot gas delivered for the months of November 2000 through February 2001, Mr. Lawrence Morris testified that he recognized that the price for spot gas was not commensurate with the confirmed transcation price for each LDC, but that as long as the price was close to the Gas Daily index price for that period, he raised no objection and ultimately paid the price specified. Thus, agreement as to price for spot sales was independent of the Master Purchase Agreement and determined on a month-to-month basis.

In the opinion of the Arbitration Panel, the Master Purchase Agreement does *not* govern the purchase price for incremental spot gas sold to MME above volumes represented by swing options for specific confirmed transactions. The price for incremental spot gas is *not* governed by the current confirmed transaction price, the weighted average cost of gas to TXU Trading, or the definition of "Contract Price" in the Master Purchase Agreement. Moreover, MME is *not* entitled, in determining the price to be paid to TXU Retail, to the benefit of TXU

Appendix C

Trading's hedges, swaps, or other financial transactions to protect or to minimize the price for the physical purchase of gas for resale by TXU Trading or for the "transfer price" to TXU Retail.

The term "Contract Price" is predicated upon NYMEX plus basis at the time the contract is entered between MME and its customer. NYMEX pricing is closed at the time that incremental spot gas purchases are made or priced, and NYMEX is inapplicable to spot gas purchases for next-day gas, in any event. Under the Master Purchase Agreement "Contract Price" for confirmed transactions was based upon cost of gas to TXU Retail plus a margin to TXU Retail of the greater of 3¢ or 25% of MME's gross margin on the sales price. However, it would appear that agreement as to the purchase price of even confirmed transactions was never determined in that manner. MME did not inform TXU of its margin, and the price was consistently set without regard to the "Contract Price."

MME shifted a substantial portion of its purchases over time from confirmed transactions to incremental spot purchases. The term "cost" for purposes of incremental spot purchases is based upon fair-market price at the time the request for incremental volumes is made by MME, and TXU's witnesses Messrs, Gibbs and Kralich explained the methodology for reaching the internal transfer price between TXU Trading and TXU Retail. MME accepted that calculation and paid the price so determined until January and February 2001, challenging the price for incremental gas for the months of November 2000-February 2001. Since MME purchased and resold the incremental gas for those months, the question

then becomes whether the price charged on a monthly basis by TXU to MME for incremental spot gas for November through February was resonable in light of the market place during the four months in question. Since the price set out on each monthly invoice for each LDC delivery point is a weighted average cost of spot gas for both gas requested prior to the closing of pipeline nominations and incremental volumes requested on a day-to-day basis or during some periods within a month of delivery, one must look both to whether TXU retail sales prices were within the range of applicable indices and whether the methodology used in those four months was generally consistent with that used in months prior thereto.

The Arbitration Panel finds that the method was consistent with a few exceptions and that the price set was within the range of the applicable indices. No evidence was introduced in support of a cliam that TXU Retail artificially increased prices or "gouged" the price for incremental spot sales during this volatile perior. Accounting errors were made with respect to which index was used as a benchmark for pricing certain limited volumes (i.e. Inside FERC or Gas Daily), which error amounts to an overcharge of $64,255.00. TXU's methodology for pricing in January varied from that used in prior months by 14¢ per dekatherm for 225,106 dekatherms resulting in an overcharge of $31,515.00. One could argue that a few other accounting errors were made, but should have been addressed in the MME audit and joint party stipulation entered just prior to the hearing on, the merits in this matter. Any other such accounting issues are thereby waived.

Appendix C

TXU Retail charged an added margin for deliveries to a few customers of MME in December and one in January. TXU argues and testimony supports that such additional charge was not added profit, but a 50¢ charge per dekatherm of incremental gas attributable to fees for additional services requested by MME for daily and monthly balancing, imbalance trading to avoid penalties, and monthly allocations with LDCs. MME disputes whether such services were provided except as to PECO, and Mr. Lawrence Morris testified that, in any event, no agreement was reached as to whether a fee would be charged let alone what the reasonable value thereof should be. The Panel is of the opnion that valuable services were provided at the request of MME, eliminating substantial risk for LDC imbalance penalties. However, the Panel questions the reasonableness of the charge for the service especially when no basis for 50¢ a dekatherm was presented and such services were charged at 5¢ during the same period for CNG South Pool. Our collective experience is that fees of this nature were added soley to incremental gas purchases because balancing was acheived with spot gas; that the volatility of the market at the time in question justified higher fees than 5¢, but that 30¢ per dekatherm and not 50¢ was a more appropriate charge. Moreover, such charges for PSE&G should have been made on TETCO volumes only. Accordingly, $78,737.00 should be credited to the amount owed by MME for November 2000 – February 2001, representing an overcharge to MME for balancing services provided with respect to sales to PECO, PSE&G, E Town, and S Jersey.

With those exceptions, the prices charged for incremental volumes were consistently priced and properly reflected

market price on the dates volumes were requested and delivered.

Accordingly, IT IS ORDERED that,

1. TXU shall, in accordance with the Arbitration Panel's ruling above, credit to MME a total sum of $174,507.00 against the amount stipulated in paragraph 2 as due and owing by MME to TXU Retail.

2. TXU filed a counterclaim in this matter with respect to amounts that remain due and owing by MME for natural gas delivered prior to the termination of the Master Purchase Agreement and billing errors, if any, with respect thereto. TXU and MME reached a settlement and stipulation pursuant to which MME shall payto TXL $2,005,373.19, subject to credit/reduction otherwise due MME as a result of this arbitration. That credit is limited to the amount referenced above in paragraph no. (1) in conjunction with the pricing of sales of incremental spot gas and balancing fees during the months of November 2000 through February 2001. Accordingly; MME shall pay to TXU the amount of $1,830,866.19.

3. The contract provides that the "defaulting Party" *shall* pay all reasonable costs and expenses (including attorney's fees) incurred by the non-defaulting party. Both parties have

sought reimbursement for attorney fees and costs. Who is the defaulting Party'? Most jurisdictions conclude that the prevailing party is the non-defaulting Party. In this instance, the greater award is to TXU Retail, and the crediting of overcharges by the Arbitration Panel does not arise from issues asserted by MME but from accounting errors or other matters raised by the Panel in its audit of TXU Retail's charges. The credits do *not* directly relate to the reasonableness of the price charged for incremental gas volumes. As arbitrator Kasey points out, on the other hand, however, the arbitration was initiated in the first instance to obtain information MME claims TXU would not voluntarily provide and sought a reduction in the amount owed. Accordingly, MME withheld payment; for these reasons, Mr. Kasey objects to the award of attorney fees and costs. In short, neither side has "clean hands" completely, but TXU prevails to the extent that some award for reasonable costs and attorney fees is due under the contract. It is the order of the Chairman pursuant to Articles 12.1 and 14.1. that TXU may recover one-third of attorney's fees paid to Hunton & Williams to defend the arbitration and one-third of costs excluding the fees of its appointed arbitrator. Affidavits of fees and costs shall be submitted to the Chairman, and MME may challenge the reasonableness of any charge.

4. The request of MME for payment of attorney and expert fees, administrative costs, and expenses of the Arbitration is DENIED. The administrative cost of the Arbitration and the fees and expenses of the Chairman of the Arbitration Panel shall be borne equally by Claimant and Respondent, and the fees and expenses of the appointed members of the Arbitration Panel shall be paid by the party appointing that arbitrator.

_____s/_____
ERNEST L. EDWARDS, CHAIRMAN

March 3, 2003

Appendix C

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

No. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.

Claimant,

VERSUS

TXU ENERGY TRADING CO.-L.U.

Respondent.

FINAL ORDER

As part of the March 3, 2003, Arbitration Award, TXU Energy Trading Co. ("TXU") was allowed to submit statements of attorneys' fees in the amount of $319,013.52 and costs and expenses in the amount of $82,567.47 of the arbitration (excluding the fees of its appointed arbitrator) incurred in this matter for which they would be reimbursed by Metromedia Energy, Inc. ("MME") for 1/3 of the reasonable attorneys' fees and costs submitted. Affidavits, time records, and cost accounting documentation was received in early April from Hunton & Williams on behalf of TXU, and, as permitted by the Arbitration Award, a Challenge to the Reasonableness of TXU's Attorneys' Fees and Costs was submitted on MME's behalf by Davis, Cedillo

& Mendoza on April 9, 2003, seeking first a ruling that TXU failed to prove that its fees and expenses are reasonable under Texas and New Jersey law, and that TXU's own actions created the need for the arbitration and that thus it should be awarded no attorneys' fees or costs and expenses. In the alternative, MME requests a disallowance of $45,555.25 in attorneys' fees and $5,024.47 in claimed expenses.

After giving due consideration to the arguments and briefs of both parties and to the support for the claim of TXU for reimbursement of 1/3 of its reasonably incured attorneys' fees and reimbursement of costs, IT IS ORDERED that,

1. MME's request that TXU's claim for reimbursement of attorneys' fees and costs to be rejected is hereby DENIED.

2. MME's claim for reduction in TXU's proposed reimbursment of attorneys' fees and costs is GRANTED IN PART and DENIED IN PART, such that TXU is entitled to reimbursment by MME of $99,787.06 for attorneys' fees, and $26,470.82 for costs. The amount must be paid directly by MME or the pevious credit granted to ME by the Arbitration Award adjusted by the total of $126,257.88 if the prior award has not been paid.

Appendix C

3. The total fees payable to the Chairman of the Arbitration Panel shall be $49,564.83, which have now been deposited with the American Arbitration Association and paid to the Chairman of this Panel.

_____s/_____
ERNEST L. EDWARDS, CHAIRMAN

May 1, 2003

APPENDIX D — EXCERPT OF MASTER GAS SALE/ PURCHASE AGREEMENT DATED OCTOBER 8, 1998

MASTER GAS SALE/PURCHASE AGREEMENT

* * *

ARTICLE XIV
ARBITRATION

14.1 *Arbitration.* Except as otherwise provided in Section 12.1 or any Confirmation, any disagreement, difference, or dispute among the Parties arising under this Agreement shall be resolved pursuant to arbitration according to the procedures se forth in this Article XIV. Either Party may commence an arbitration proceeding hereunder by giving written notice to the other Party. No later than five (5) Business Days after the delivery of the notice commencing the arbitration proceeding, Seller and Buyer shall each select an arbitrator. Promptly following their selection, the arbitrators selected by Seller and Buyer jointly shall select a third arbitrator. The third arbitrator shall hear and decide all matters relating to the dispute that is subject to arbitration. All arbitrators selected under this Agreement shall have at least eight (8) years of professional experience in the commodity markets and in the business of marketing Gas, and shall not previously have been employed by either Party and shall not have a direct or indirect interest in either Party or the subject matter of the arbitration. The arbitration hearing shall commence as soon as is practical, but in no event later than thirty (30) days after the selection of the third arbitrator. If any arbitrator selected under this Section 14.1 should die, resign, or otherwise be unable to perform his duties hereunder, a successor arbitrator shall be selected pursuant to the procedures set forth in this Section 14.1.

Appendix D

14.2. *Law Governing Arbitration.* The arbitrator shall settle all disputes in accordance with the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association, to the extent that such Rules do not conflict with the terms of such Act or the provisions of this Agreement. The decision of the arbitrator shall be binding on the Parties and, if necessary, may be enforced in any court of competent jurisdiction. The charges and expenses of the arbitrators shall be shared equally by the Parties.

* * * *

APPENDIX E — EXCERPT OF STATEMENT OF CLAIMS IN THE COURT OF ARBITRATION, AMERICAN ARBITRATION ASSOCIATION DATED APRIL 26, 2002

IN THE COURT OF ARBITRATION
AMERICAN ARBITRATION ASSOCIATION

Arbitration No. 71 Y 19800887 1

METROMEDIA ENERGY, INC.

Claimant,

vs.

TXU ENERGY

Respondent

STATEMENT OF CLAIMS

* * *

IV.
Causes of Action

4.1 *Breach of Contract.* TXU has failed to comply with the terms of the Agreement:

A. Pursuant to Section 74 of the Agreement, MME is entitled to audit the books and records of TXU to verify the accuracy of any

billing invoice, payment, demand, charge or calculation with respect to the relevant transaction. TXU has wholly failed to allow MME to inspect the records of TXU.

B. Pursuant to Section 7.2 of the Agreement, the parties agreed that disputed amounts are not due and payable until fifteen (15) days *after* final resolution of the dispute. MME has disputed over $12 million in winter 2000-2001 invoices by TXU for spot sales, which have not been resolved due to TXU's failure to provide any supporting documentation for its invoices. Therefore, said disputed amounts are not yet due. Nevertheless, TXU has exercised a letter of credit designed to secure payment when due. Since the dispute has not yet been resolved, TXU wrongfully drew on this line of Credit in the amount of $10 million.

C. TXU has further violated the Agreement by supplying gas to MME for spot purchases made between November 2000 and February 2001 and subsequently overcharging MME for said purchases. Since TXU has not complied with Section 7.4 of the Agreement, MME cannot determine at this time the exact amount TXU has overcharged.

* * * *

APPENDIX F — EXCERPT OF TXU ENERGY SERVICES N/K/A TXU ENERGY RETAIL COMPANY, L.P.'S SECOND AMENDED RESPONSE TO METROMEDIA ENERGY INC.'S STATEMENT OF CLAIMS AND ORIGINAL COUNTERCLAIM DATED JULY 29, 2002

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

NO. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.,

Claimant,

vs.

TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.,

Respondent.

TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.'S SECOND AMENDED RESPONSE TO METROMEDIA ENERGY INC.'S STATEMENT OF CLAIMS AND ORIGINAL COUNTERCLAIM

* * *

Appendix F

TXU ENERGY'S COUNTERCLAIMS

MME breached and continues to breach Article 7.1 of the Agreement by failing to share the Gross Profit with TXU Energy. Additionally, MME breached and continues to breach Article 7.4 of the Agreement by failing to provide documentation from which TXU Energy can calculate the share of Gross Profit to which it is entitled.

MME also breached and continues to breach Article 13.2 of the Agreement by failing to pay TXU Energy for MME's liquidated forward positions and other amounts owed, including interest.

* * * *

APPENDIX G — EXCERPT OF PROCEEDINGS

[Commencing at page 4]

ARBITRATOR EDWARDS: I'd like to call the hearing on the merits in the arbitration brought by Metromedia Energy against TXU Energy Trading Company to order.

Are there any preliminary matters that either side wishes to take up this morning before we hear our first witness?

MR. CHISCANO: We do have – I have a couple matters, but probably the most important one is that we arrived to at least a partial settlement of the universal claims out there.

ARBITRATOR EDWARDS: That's terrific.

MR. CHISCANO: Mr. Lillard was kind enough to allow my clients and his clients to visit yesterday, and they did come to an amicable resolution to the outstanding amounts due and owing between the parties, which relates to TXU's counterclaims against Metromedia.

* * *

[16] Also in light of the settlement, Metromedia will withdraw its argument about wrongful withdraw on a letter of credit because that settlement kind of takes – takes care of that. So that issue, the claim for wrongful withdrawai, will not be pursued, which I believe in the Statement of Claims was section 4.1B is where it's set out there.

* * * *

APPENDIX H — EXCERPT OF RESPONDENT'S POST-ARBITRATION BRIEF DATED DECEMBER 4, 2002

BEFORE THE AMERICAN ARBITRATION ASSOCIATION

NO. 71 Y 198 00887 1

METROMEDIA ENERGY, INC.,

Claimant,

vs.

TXU ENERGY SERVICES n/k/a TXU ENERGY RETAIL COMPANY, L.P.,

Respondent.

RESPONDENT'S POST-ARBITRATION BRIEF

Respondent TXU Energy Services n/k/a TXU Energy Retail Company, L.P. ("TXU Energy")[1] files this post-arbitration brief as follows:

* * *

---

1. TXU Energy acquired Enserch Energy Services, Inc. in August 1997 but the name did not change until 1999. Tr. 718; *see also*, TXU Ex. 19. For consistency, we will use the name "TXU Energy" and not distinguish between TXU Energy and Enserch Energy Services, Inc. throughout this Brief.

Appendix H

III.

ARGUMENTS

A. THE TRIAL TESTIMONY ESTABLISHES THAT TXU ENERGY DID NOT BREACH THE AGREEMENT BECAUSE THE AGREEMENT DOES NOT COVER THE PRICE OF SPOT GAS

1. The Parties' Course Of Performance, Or Intent, Established A Separate Agreement For Spot Gas

The evidence establishes that through its course of performance initiated through its own actions, or based on the intent of the parties, MME created a separate contract that governed its spot gas transactions.

* * * *

2

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SUPREME COURT, U.S.

No. 05-295

IN THE

Supreme Court of the United States

METROMEDIA ENERGY, INC.,

Petitioner,

v.

ENSERCH ENERGY SERVICES, INC.; TXU ENERGY COMPANY LLC; TXU ENERGY TRADING; TXU ENERGY SERVICES, N/K/A TXU ENERGY RETAIL COMPANY, LP; TXU JOHN DOES,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Is an arbitrator's interpretation of the scope of the issues submitted, particularly when the parties fail to precisely set them out, as was the case here, reviewed by a federal court deferentially, as held by the Third Circuit below, or *de novo*, as maintained by Petitioner?

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Respondents[1] make the following disclosures:

1. Respondent TXU Energy Retail Company LP: Its general partner is TXU Retail Management Company LLC and its limited partner is TXU Energy Retail Investment Company LLC, both of which are owned by TXU Energy Company LLC, whose parent company is TXU US Holdings Company. TXU US Holdings Company's parent company is TXU Corp., a publicly held company.

2. Respondent TXU Energy Company LLC: Its parent company is TXU US Holdings Company, whose parent company is TXU Corp., a publicly held company.

3. Respondent Enserch Energy Services, Inc.: It no longer exists.

4. Respondent TXU Energy Trading: There is no company with this name. It was an assumed name of TXU Energy Trading Company LP, which no longer exists and which was indirectly owned by TXU Corp., a publicly held company.

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1. Included among the defendants in this lawsuit were "TXU John Does," which were described in Paragraph 3 of MME's Amended Complaint as "fictional subsidiaries and/or affiliates of TXU Corp., which entities' specific identities are unknown at this time."

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STATEMENT OF THE CASE[2]

This case involves the review of an arbitration award that, among other things: (1) found that Respondent TXU Energy Retail Company LP (TXU Retail) did not overcharge Petitioner Metromedia Energy, Inc. (MME) for its "spot-market" natural gas purchases during the period from November 2000 through February 2001 (the Disputed Period); and (2) awarded TXU Retail one third of its attorneys' fees incurred in the arbitration as the "non-defaulting party" within the meaning of the attorneys' fees provision of a 1998 Master Gas Sale/Purchase Agreement (the Master Agreement) between MME and TXU Retail.

A. MME's gas purchases from TXU Retail.

MME is a natural gas retailer that sells natural gas to end-users in the northeastern United States. As of October 8, 1998, it entered into the Master Agreement with TXU Retail's predecessor[3] to secure a portion of the natural gas it was contractually obligated to supply to its custc ers. Under the Master Agreement, MME could purchase gas from TXU Retail only pursuant to written confirmations that specified the purchase's term, volume, and price.

As natural gas prices began increasing significantly, MME shifted its customers from fixed-price contracts to "cost-plus" contracts so its customers would bear the risk of future gas price increases. It also began purchasing natural

2. The Petition for Writ of Certiorari will be cited as "Pet." The Petition's Appendix will be cited as "Pet.'s App."

3. The Master Agreement, which was executed by MME and Enserch Energy Services, Inc., was assigned to TXU Retail.